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Fagerhult Group AB (FAG.SE)

Q3 2024 Earnings Call

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MANAGEMENT DISCUSSION SECTION

Operator: Welcome to Fagerhult Group Q3 Report 2024. During the questions-and-answer session, participants are able to ask [Operator Instructions] .

Now, I will hand the conference over to head of M&A, Magnus Haegermark. Please go ahead.

Magnus Haegermark

Head-Mergers and Acquisitions, Fagerhult Group AB

Thank you. And hello, everyone. Welcome to today's presentation of Fagerhult Group's third quarter results for 2024. My name is Magnus Haegermark. I'm the Head of M&A here at Fagerhult Group.

On the call today, we have our president and CEO, Bodil Sonesson; and our CFO, Michael Wood. The presentation will start with Bodil giving us a brief update on the results for the third quarter. Bodil will then continue to update us on some strategic highlights today, focused on what has happened since the fluorescent ban was initiated and what we can do to help our customers with LED lighting, renovation and smart solutions.

After that, Michael will follow with more details about the performance of the Group. Finally, Bodil will conclude with a recap, and then, we will open up for questions. We will first take questions from the conference call. Then, we will open up for questions from the webcast. You can pose questions in the chat window on your screen and I will read them up for Bodil and Michael.

Before we start, let me also remind you that today's session is recorded and will be available on our website later today.

With that, I hand over to you, Bodil. Please go ahead.

Bodil Sonesson

President & Chief Executive Officer, Fagerhult Group AB

Thank you, Magnus. And welcome from me as well to everybody to this Q3 2024 webcast. So, the third quarter results were not in line with our ambitions, caused by a softer market conditions over the later part of the summer. We have, therefore, taken actions with an even higher focus and cost reductions in the group. And as you know, we started this in Q2 and we start to see the effects of it already. Additionally, we have also executed on restructuring programs in three entities, Veko, LTS, and Arlight. In Veko, this also included the final withdrawal from the horticulture market, in combination with the strategic overview of the business that was announced in Q2. We expect the benefits in operating margin in Q4 as well as in 2025.

In the market, we still see large differences in activity depending on both geographies and segments and whether it's public or private spending. Being present in many markets and segment is one of our big benefits.

From customers and projects, during the summer, we saw a slower decision-making process caused by the general market conditions, which was more visible in Collection. Also, there are some specific events like the UK election that slowed down decision making in public spending. Premium, that is more involved in public spending in the Nordics, for example, in hospitals, and there's a high level of renovation project had a much better quarter with an organic order intake of 6.6%.

We also see positive signs from the fluorescent ban, and I will come back to that later on in the presentation. That means that we see continued – megatrends continue to support and remain favorable for our industry that does not change and provide a solid foundation for our strategy and future growth, which is completely in line with our strategic focus areas. So, we continue to work hard and make progress in smart lighting, sustainability and people and talent.

And as an example, we have, this quarter, done our first launch of our cloud-based service offering in smart lighting. The service launch will be my focus from an innovation standpoint in today's presentation, and you can in the report read about another few innovations that we have launched in the quarter, as we continue product development activity on a high level. But let's start, as always, but have a quick look at the numbers for the quarter. And first, I want to point out that we have presented our results based on the commonly used concept of items affecting comparability. This is to provide completely clarity and assist in the understanding of the numbers and the results.

So, order intake in Q3 was SEK 1.873 billion, which represents an organic decline of 5.1%, and net sales at SEK 1.919 billion showed an organic decline of 5.2%. At the EBIT level, we delivered SEK 181 million with a 9.4% EBIT margin and EPS was SEK 0.58 per share.

And if we then look at the quarter-to-date in figures, the year-to-date order intake is at SEK 6.106 billion, which represents an organic decline of 2.5% compared to 2023. And net sales declined organically, with SEK 2.2 billion to SEK 6.266 billion compared to 2023. And operating profit is at SEK 598 million, which represents an operating margin of 9.5% and EPS is SEK 1.99 per share. And as always, Michael will give you more information when we come to the financial section of this presentation. And first, I will show you some things that have happened in the quarter.

So, as always, we give you a flavor of our strategic group focus areas. And today, we'll give you a quick update on the fluorescent ban and what it means for our renovation business and focus, and we will also investigate what advantages it brings to work with our smart solutions, Organic Response in renovation projects. And in the first stage, as a control system, and how that becomes a bridge into continued energy optimizations for our

customers. And then, we will look into the future with the soft launch of the service offering for smart lighting that happened this quarter.

So, you probably remember that fluorescent tubes, as part of the ROHS directive, were banned a year ago in Europe, and the UK followed six months later in February 2024, and the ban prohibited EU production and EU importing of fluorescent tubes. But what was already held in inventory on the market were allowed to be sold. So, that's the background.

And our expectations were that inventory levels to be quite substantial and that it would take time for the phase-out. The indicators we now see, this is happening far quicker than we thought, and that inventory levels are going down quickly in Mainland Europe and somewhat slower in the UK, which is normal as they were six months after us. So, this positive news as it generates more opportunity for renovation projects and as we spoke about in Q1, we have several renovations and refurbish concepts within the group.

So, if we look at the replacement for existing fluorescence installation, we offer two different possibilities. We can do retrofit of the luminaire and upgrade it to new LED technology. This will give the customer the lowest carbon footprint option, and it's very cost effective. We will also make sure that we quality-test the solution so that it's CE Mark is kept. In some cases though, it might make sense as you see the second option here, to go for new LED lighting solutions.

In both cases, we will recommend a solution with sensors to optimize the energy consumption and make the solution futureproof.

There is a third solution that exists that we don't do, which is to use LED tubes, and we don't recommend this. It might at first seem like a cost-effective solution to use LED replacement lamps, but the fact is that they have, one, they have a shorter life expectancy, they are 20% to 30% less energy efficient than a new or professionally upgraded LED luminaire. And that makes, if you look from a total cost of ownership, this is – the option is actually costing more than the other more professional solution. Also with LED lamps, you need to make sure that the original CE market is still valid for the solution.

As you know, we have a vision to be 100% smart by 2030, and this implies that by 2030, we need to have sensors in all our lighting solution. And this goes hand in hand with us achieving our sustainability targets.

So, our in-house developed smart lighting solutions for indoor application is called Organic Response. And this system provides a very easy stepping stone into smart lighting, because the solution can, in its first phase, be deployed as a lighting control system where the wireless capabilities make system design and installation easy and cost-effective as no separate communication cables needs to be pulled through the building. And this is a huge saving for the project and those involved.

And the easy commissioning and speed of deployment, thanks to wireless, makes the solution ideal for renovation projects. And in this first phase, the system can deliver energy savings up to 40%. And then, by adding gateways and connecting the system to the network, we can, in the second phase, allow the customer to start reaping the full benefits of smart lighting, including energy savings, up to 70%. So, what you see here on the slide, trying to present it in a pedagogic way.

And the updated European Performance of Buildings Directive (sic) [Energy Performance of Buildings Directive] (00:17:44) implies smart lighting solutions in new and renovated buildings, and the Member States needs to implement this new directive into local legislation by the latest of Spring 2026.

So, this quarter, we passed an important milestone within our smart lighting initiative with the launch of a service offering for Organic Response, and the service will help us to speed up the adoption and articulate the benefits with smart lighting. And as you can see here on the slide, it's a tiered offering, and the service will optimize the performance of the lighting system through the whole lifecycle and help our customers to meet their sustainability targets while ensuring a quality lighting experiences.

So, for the brand companies in the group, the services are also a tool that will allow a closer interaction with key stakeholders, including real estate owners, real estate managers and larger end customers who value the benefits with smart lighting. So, if you want to read more about the solution, I recommend you to go to the website of [organicresponse.com](https://www.organicresponse.com) that has been completely updated during the last months to reflect the new solution. And I'm sure we will be coming back to this topic also in future webcasts.

I will end this section with an example of a nice project from Whitecroft that was won this quarter. It's a very nice proof point of what we've just been talking about with smart lighting and about sustainability. It's an office building in London's new Net Zero Business and Innovation District at Brent Cross. The whole project has, therefore, had high focus on sustainability and energy efficiency. And Brent Cross is one of the key growth projects of the Mayor of London, and will, when it's ready, house offices for 27,000 people and will be a completely new town center location.

And this building that we look at here, you can see it's partly in wood. It's called Brent Cross 1, and it's the first commercial building to be part of the Brent Cross Regeneration Scheme, designed and built by the construction company, BAM, for the real estate company, Argent Developments, and BAM and Argent selected Organic Response wireless control solution due to its energy savings, ease of installation, future-proof flexibility and ability to integrate with other building services.

So, with that, I will hand over to Michael with the picture of a university project in Tasmania, which is this time is done with WE-EF Lighting, and it's situated near a penguin colony. So, the campus is therefore a ecologically sensitive zone and has very special demands with the approach to lighting.

So, with that, please go ahead, Michael.

Michael Wood

Chief Financial Officer, Fagerhult Group AB

Thank you, Bodil. And good morning to all our guests from me as well. As Bodil mentioned, the results for the third quarter did not meet our expectations or ambitions. I am, however, confident that as a result of the enhanced cost focus plus the three restructuring programs, the group's profitability will benefit in the coming periods. The enhanced cost focus comes from a very – sorry, comes from every business in the group, and we already, we see an average of SEK 6 million per month reduction in those targeted areas.

The three restructuring programs in Veko, LTS, and Arlight reduced the group's head count by approximately 2%, and the payback for the organizational restructuring starts in November and will take just over eight months for a full payback return on the [ph] IACs (00:21:55) that have gone through in Q3.

The impact of the softer market conditions can be seen here in the lower net sales level, but with a positively developing gross profit margin and a current and enhanced ongoing cost base reduction, the operating margin is at a steady level.

Remember that the Q3 results does not include the benefit from the restructuring programs. This will start during the fourth quarter and take us into next year. Order intake levels were better towards the end of the quarter and have remained at a better level since, and we are monitoring this very closely, as you might expect. The group's ability to meet customer delivery expectations is at a good level across all brands, and this is a strength of our operating model with lead times from some factories being three to four weeks. So, [ph] then (00:22:49) what we see is longer decision-making but shorter lead times when that decision is made, and we have the capability to respond to that.

The improved gross profit margins are due to quite a few things. Active portfolio management is an ongoing process here at Fagerhult Group in all brands. Pricing techniques and material cost reduction and all these activities have contributed for the ongoing development of the GP margin.

Operating cash flow remains healthy with an ongoing high degree of inventory and accounts receivable focus on management. And in the fall – sorry, with the fall we are seeing in the Europe for bank rates, the interest expense is also expected to reduce in coming quarters, plus we expect the net debt to reduce further in the rest of the year.

If we look at the year to date, net sales are organically 2.2% adverse to last year. We begin to encounter currency headwinds. As you can see there, it switched from [ph] plus 6 to minus 45 (00:23:53) in the quarter on the FX differences, beginning to see currency headwinds from the tailwinds that were there for the first six months of the year.

Profitability will be improved as a result of the cost focus and the restructurings, and this will enhance the margins and earnings per share going forward. Operating cash flow remains healthy. The group is a good cash conversion process and executes well year after year.

Sales development. Due to the softer market conditions, we can see the rolling 12-month net sales took a slight dip in the period but remains at SEK 8.4 billion . There are many opportunities on the market and the megatrends remain supportive and favorable. When the newbuild market activity begins to return, we will see a further improved position here.

A point to make here is regards to the UK market. Bodil has mentioned a couple of specifics regarding the UK market. The UK market is particularly impacted by the recent governmental election, the temporary lower levels of public sector investment, plus the liquidation of ISG, one of the largest installers on the market. In 2023, ISG's net sales number was £2.2 billion. So, it is a sizable contractor, and as it shapes the supply chain in the industry when something like that happens.

As a result of all these things combined, net sales in the third quarter 2024 were SEK 111 million lower than in Q3 2023.

Margin. The rolling 12-month operating margin before IAC holds steady at 9.5 to 10.5 percentage points, and this will be improved by the cost focus and the head count reduction. Further development should be possible when the markets return to a more active level.

Collection [indiscernible] (00:25:55) has had a weaker order intake period during the summer period, operating in the high end segments of the industry. Business area Collection has seen the most instances and biggest impact of the longer decision-making process and, therefore, project delays and postponement of deliveries where the order has already been received. So, we're seeing it in two areas, particularly strongly in Collection. Slower and

longer decision-making to win new orders, and then many changes when it comes to executing on the delivery. There is a strong focus on cost reduction to support and protect the profitability, and it's important to point out that over the longer term, we see a dip in the quarter, but over the longer term, the operating margin continues to develop in a positive way. This has been the trend during the last few years and we see it continuing.

Bodil mention the growth in Premium. BA Premium has had its strongest order intake and profitability period for the year in the third quarter. Organic order intake was plus 6.6% growth and the operating margin at 13.7% is the highest this year. The Fagerhult brand is already benefiting from the fluorescent lamp ban as these inventory levels begin to be fully consumed in some markets, and we do expect this to continue. We see a very strong future for smart lighting solutions and viewing the result for business area Premium, with respect to the growing investment in organic response, resulting in an industry-leading year-to-date operating margin of 14.8% here, year-to-date, when you see the combination of the lighting brands without the investment in organic response. So, healthy operating margin for the two businesses.

The restructuring program at LTS will begin to deliver further benefit to the operating margin in Premium, and that will positively impact in the fourth quarter and into 2025.

Looking at Professional, whilst the longer term trend for profitability for – is positive for BA Professional, the third quarter was disappointing. In the UK, we continue to see positive year-on-year development in sales and profitability. In Australia, we continue to see a steady and in control operation, but steady at the low level. And the ambition – you're aware of the difficulties that we had in 2021 and 2022, and the ambition has been to create a stable, more in control platform in Australia and the new leadership team is delivering upon that plan. In coming years, we plan for growth down in Australia.

In Turkey, market conditions are particularly tough. And here, we also execute on a restructuring program to reduce the cost base.

Bodil has mentioned, so I'll repeat it, the Brent Cross project is a proof point of how the market is turning and how our businesses offer winning solutions for lighting and sustainability.

Lastly, Infrastructure. Infrastructure [indiscernible] (00:29:09) 90 days ago, created some conversation points. And in the Q2 report and on the Q2 earnings – sorry, Q3 earnings call, we reported a full review of the Veko business. This has been completed, and we finalized the withdrawal from the horticulture segment, as well as execute on a significant head count restructuring program in Holland. The operating margin has partly recovered. You can see clearly on the right-hand side, have partly recovered in the third quarter, and we expect further improvement to come.

Order intake in the business area has now been positive for both Q2 and Q3, and we look to close out the year in a good way and look for further improvement in 2025.

Cash flow. On the cash flow side, we do continue in a very positive way now with 10 successive quarters of generating a positive cash flow. It will, as previously reported, be difficult to match the SEK 1.2 billion achieved in last year, but we do still see room for improvement in some businesses in improved working capital management.

As you can see, the net debt reduced in the quarter as the operating cash flow was once again quite healthy. We report a net debt of SEK 2.46 billion, adjusted to SEK 1.7 billion for IFRS 16 effects and the net debt EBITDA ratio remains less than 2, meaning we are in a strong balance sheet position for M&A opportunities.

Cost savings and the restructuring programs, combined with lower interest expenses and the medium term lowering of the group's tax rate will all improve the earnings per share, and these are all activities that we see no reason why these can't be executed and delivered upon.

Before handing back to Bodil for closing and Q&A, just a very short summary message. Yes, the softer market conditions did affect the group's result in the third quarter. During Q3, we have taken many difficult decisions. We have a focus on cost reduction. I'm confident this will improve the result going forward. The mega trends increasingly impact the business in a positive way. Brent Cross and the fluorescent lamp ban are examples of this and test cases which are very positive towards our strategy. And despite the softer market conditions, there is no reason to lack confidence for the medium term.

And with that, I say thank you for listening. And I hand back to Bodil.

Bodil Sonesson

President & Chief Executive Officer, Fagerhult Group AB

Okay. So, here, we see a picture from a church in Denmark, in the city of Silkeborg. Normally, we show you renovation of old churches. And this time, it's a completely modern newbuild brick church. It's an iGuzzini installation. And they have, as you know, a big focus on the cultural segment. And where this quarter, they have launched a new solution, which has focus on museums.

And as Michael said, and we – when we look into the conclusions and recap for this quarter, we saw longer decision-making processes from the customers and they – that has been impacted us, and I think it's very much due to the general market conditions. We still see high activity levels, though, in our incoming pipeline. That hasn't changed. And we also see some positive signs for future trends in the construction industry for 2025.

Also, positively, the inventory of old fluorescent lamps seems to be diminishing quicker than we thought, and that should have a positive impact on the uptake – continued uptake, I would say, on renovation projects.

With the uncertainty around us in the market, we continue our cost focus in the group to support our operating margin. And as you know, we have executed three restructuring programs that will impact results positively on the operating margin in Q4 and in 2025. The renovation focus also benefit our sales of smart lighting as the easy commissioning and speed of deployment, thanks to wireless, makes the solution ideal for this type of situation.

Q3 also marked the launch of our service offering with additional energy savings potential for our customers, and we continue to be convinced that we are doing the right actions towards our ambitious goals and that we are well positioned when the construction market again turn positive.

And with that, I will hand over to Magnus and questions that we might have.

QUESTION AND ANSWER SECTION

Magnus Haegermark

Head-Mergers and Acquisitions, Fagerhult Group AB

A

Thank you, Bodil. With that, we ask the Operator to open for questions from those on the telephone line.

Operator: [Operator Instructions] The next question comes from Karl Norén from SEB. Please go ahead.

Karl Norén

Analyst, Skandinaviska Enskilda Banken AB

Q

Yes, good morning, Michael and Bodil. Couple of questions from my side. Maybe to start off with a clarification one, on the payback time here on the restructuring. I think you said it was one and a half year approximately. So, I'm just wondering if we should read that as like SEK 40 million in annual savings. But I also think that, Michael, you said that you already saw some like SEK 6 million cost reduction per month. So, just if you could comment a little bit on that would be helpful.

Michael Wood

Chief Financial Officer, Fagerhult Group AB

A

Yes, sure. Thanks, Karl. Good morning, by the way. Two things going on here. There is that – across all the businesses and all the group, there is – there is a high degree of cost focus that we initiated towards the end of the second quarter, and that's delivering, on average, SEK 6 million saving per month in those targeted areas. Additional to that, then there is the three restructuring programs that we execute: Veko, LTS and Arlight. And that, at Veko, also includes the withdrawal from the horticulture segment.

If you just look at the organizational restructuring programs, then the payback for those will start in November and will be completed within eight months with 100% payback of the cost of the programs for organizational restructuring. In the report, we state a longer time period because that includes also the impact of the withdrawal from horticulture segment. So, there's no – there's no actual payback, if you like, for that, except a healthier business and more focused business. So, the number that you see in the report card is the organizational savings, also funding in 1.6 years, both aspects of organizational as well as horti withdrawal.

Karl Norén

Analyst, Skandinaviska Enskilda Banken AB

Q

Understood. That's very clear and helpful. And just a question also on Collection here. I mean, you grow organically, but despite the growth, the margin seems to come down year-over-year. Is it possible maybe to tell us a little bit more what's going on in the Collection area? And also, I saw that the order intake in Collection was a bit weak. So, if you could give any more color on the Collection developments would be nice.

Michael Wood

Chief Financial Officer, Fagerhult Group AB

A

Yeah. I'll cover order intake first. The four businesses in Collection do operate at the high premium end of the lighting industry, offering architectural and lighting design solutions where the price premium that they – that they receive for that products is at a good level, and that segment we noticed over the last three to four months has been subject to the highest degree of project deferrals, project postponements, and the decisions to execute on

placement of the purchase orders has become longer and longer, and we notice it more in that high-end segment than we do in our other business areas.

When you come to the operating result, we've got four businesses in the business area Collection. Looking at the year to date, operating margin is ahead of last year, so we are pleased about that. So, even through a softer summer period on order intake, giving a quite a difficult Q3 performance, we're still ahead of where we were a year ago in our operating margin.

It is the trend that we have seen since the acquisition of iGuzzini in post-COVID period, and we do fully expect that to continue. So, we see – Karl, we see the Q3 margin as a one-quarter sort of a bit of damage to that...

Karl Norén

Analyst, Skandinaviska Enskilda Banken AB

Q

Okay.

Michael Wood

Chief Financial Officer, Fagerhult Group AB

A

...present figure. But I think the longer term, we've been successful in producing a little bit more and a little bit more as we go through, and we have no reason to doubt that that will continue.

Bodil Sonesson

President & Chief Executive Officer, Fagerhult Group AB

A

And I also think, Karl...

Karl Norén

Analyst, Skandinaviska Enskilda Banken AB

Q

Okay, yeah I...

Bodil Sonesson

President & Chief Executive Officer, Fagerhult Group AB

A

If you look into the longer lead times, I think it's because Collection is more exposed to newbuilds than the other business areas are.

Karl Norén

Analyst, Skandinaviska Enskilda Banken AB

Q

Yeah, that's clear. Very good. And then, just a general question on demand for the group. I mean, since [indiscernible] (00:39:35) during and after the summer, maybe, but you also sound a bit more optimistic on the fluorescent phase-out, I guess. And I mean, given what we see now, of course, I think it's going to be quite hard to show growth there in Q4, but I mean, you stated in the report that you see newbuild coming back in like 12, 18 months. Just wondering a little bit how you see on the market and when you think it's possible to see a positive organic growth for Fagerhult?

Bodil Sonesson

President & Chief Executive Officer, Fagerhult Group AB

A

I mean, it's – for us, it's by far most – our most important objective to start to show growth. And I think that when you look into construction market has been negative for many quarters in the past. I mean, if you look at the

predictions from [indiscernible] (00:40:24) they're speaking about a more positive 2025, both from renovation and newbuild, and I think if you look into this year, it has been quite special because I think it has been lower also on the renovation side.

And I think there are a lot of things that should drive this positively. Hopefully, both the market, the general market conditions from an interest rate perspective, but also as legislation is coming closer and closer, there needs to be more renovation done, and that is both in general terms. If you look into, as I referred to the European Buildings Directive – Performance Directive of Buildings (sic) [Performance of Buildings Directive] (00:41:04) but also when you see the florescent, and we are, as we said, more positive. We thought this would take a long time, but we can see that that inventory and distribution is going down very rapidly. And I think in some markets, it's even running out.

And I think we thought this would take longer term. We don't know if there is stock with the real estate companies and the facility manager, but if there is, that will happen quite quickly. So, I think that should bring some positives to us in general.

Karl Norén

Analyst, Skandinaviska Enskilda Banken AB

Yeah.

Q

Bodil Sonesson

President & Chief Executive Officer, Fagerhult Group AB

So, I think – what I said, I mean, we are confident in what we're doing. We've been taking the right actions, and that should also bring the right results.

A

Karl Norén

Analyst, Skandinaviska Enskilda Banken AB

Yeah, that's clear. And that's all for me. Thank you for taking the questions and have a good day.

Q

Michael Wood

Chief Financial Officer, Fagerhult Group AB

Thank you, Karl.

A

Bodil Sonesson

President & Chief Executive Officer, Fagerhult Group AB

Thank, Karl.

A

Operator: The next question comes from Albin Nordmark from Nordea. Please go ahead.

Albin Nordmark

Analyst, Nordea Bank ABP

Hi, Bodil and Michael. Thanks for taking my questions. I had some technical issues, so sorry if you already answered this one. But just to confirm, should we expect more – more of these restructuring costs going ahead, or have you taken all of these costs now in Q3?

Q

Michael Wood

Chief Financial Officer, Fagerhult Group AB

We've taken them in Q3.

A

Albin Nordmark

Analyst, Nordea Bank ABP

All right. And then, for the service offering here, you announced this quarter, just curious, much would you expect will be service offering versus just [indiscernible] (00:42:36) products in a few years from here? Yeah.

Q

Bodil Sonesson

President & Chief Executive Officer, Fagerhult Group AB

I think what you see what we're doing this quarter is a soft launch of it. And so, it's going to go market by markets. So, I think when you do these kind of new types of offerings, it's always good to dip your feet first. But we're going to have a high focus on it. And if you come back to where our ambition is, we're saying 100% sensors in our products in 2030, and that doesn't mean that it has to be service offering. That means that it has to be included in a sensor. But that is the prerequisite for working with the service offering, both today, of course, but also in the next steps.

A

So, I would see a gradual improvement and a gradual part of our total percent – from a percentage standpoint, it's difficult to say exactly what that's going to be. What we are seeing, though, is when it's a little bit depending on different markets. This is a very attractive offering for the customer because when they work with this, they will be able to work with their lifecycle of their products.

So, I wouldn't say that it's entirely paying off for itself. It's a little bit depending on the energy pricing, but it is a very, very interesting offering for the customers, both from a total cost of ownership, but also from working with their own real estate companies, working with their own SBTI targets to take them down. Because there is, of course, a big – both on the energy side, but also on the CO2 part. So, it's an interesting offer for the customer.

Michael Wood

Chief Financial Officer, Fagerhult Group AB

And that – just the...

A

Albin Nordmark

Analyst, Nordea Bank ABP

They offered a...

Q

Michael Wood

Chief Financial Officer, Fagerhult Group AB

Albin, sorry, just to add to that. The word Bodil used is quite a lot there in that response with the customer. It does mean, for many of our brands, that we have to partner and engage with slightly different customers to deliver this service offering. Many, many engaged with engineering consultants, architects, designers, installers, whereas, the important people to get to with this service offering is either the property developer, the landlord, or the tenant.

A

So, it's a slightly different category of customer, stakeholder, we recognize that. And that's the formulation that we're going through in our businesses on this soft launch that we have in targeted, targeted markets.

Albin Nordmark

Analyst, Nordea Bank ABP

Q

All right. That's clear. And also, I think Bodil you mentioned in – or you concluded despite longer decision-making from the customers, you see high levels of incoming business there and also positive signs from the fluorescent ban. So, can you give us any sense of maybe how October has started in terms of order intake?

Bodil Sonesson

President & Chief Executive Officer, Fagerhult Group AB

A

I think Michael said it, that – I would say that it was the summer, which was tough. So, it was better from when everybody got back and started really to work in September. And I would say so far that has continued. So, so far, so good. But of course, we are very vigilant in observing it.

Michael Wood

Chief Financial Officer, Fagerhult Group AB

A

So, we're only...

Albin Nordmark

Analyst, Nordea Bank ABP

Q

Thank you. That's – that's all from – yeah.

Michael Wood

Chief Financial Officer, Fagerhult Group AB

A

We're only two or three weeks into the fourth quarter, so...

Bodil Sonesson

President & Chief Executive Officer, Fagerhult Group AB

A

Yeah.

Michael Wood

Chief Financial Officer, Fagerhult Group AB

A

...whilst we're happy with what we see, it's a very short period.

Bodil Sonesson

President & Chief Executive Officer, Fagerhult Group AB

A

Yeah.

Michael Wood

Chief Financial Officer, Fagerhult Group AB

A

But it's better than being unhappy with what we see.

Albin Nordmark

Analyst, Nordea Bank ABP

Q

For sure. Thank you, Michael and Bodil. That's all for me.

Michael Wood

Chief Financial Officer, Fagerhult Group AB

A

No problem. Thank you, Albin.

Operator: The next question comes from Mats Liss from Kepler Cheuvreux. Please go ahead.

Mats Liss

Analyst, Kepler Cheuvreux SA (Sweden)

Q

Yeah, hi. Good morning. Thanks for taking my question. First, I'd like to get some more color there on the order mix. I mean, could you say something about volume and pricing? I mean, component prices are quite important for you, I guess. So, if you could, well, say something about that?

Michael Wood

Chief Financial Officer, Fagerhult Group AB

A

Do you want to cover the order mix, Bodil, and I'll cover the component pricing?

Bodil Sonesson

President & Chief Executive Officer, Fagerhult Group AB

A

Yeah, go ahead, Michael. You can start with the component side of it.

Michael Wood

Chief Financial Officer, Fagerhult Group AB

A

Okay. So, what we see, Mats, on component pricing, you're spot on. It is quite important to us with cost of material being the most significant line item expense in our income statement, materials, not surprisingly. We see some good lower component pricing that we're experiencing this year, particularly on LED electronics. We don't see any reason why that shouldn't continue through to the end of the year, and we are about to engage in pricing arrangements for the main volume of items going into our factories for 2025.

We do see some reductions in base metals and commodity products like steel, aluminum, copper. So, overall, components and input costs of materials is favorable this year compared to where we've been in 2023 and 2022. I don't – I'm not hearing, Mats, around the group, things going the other way when it comes to pricing of components.

Bodil Sonesson

President & Chief Executive Officer, Fagerhult Group AB

A

And then when you look into the order mix, if we look into what we saw, I tried to illustrate a little bit. I mean, it is big differences depending on the markets and the segments and one market – one segment can be good in one market and less good in another one. And a typical example of that was that we saw delays. And Michael highlighted to the UK, I think in terms of our numbers, geographically, UK had a very good quarter in Q3 last year, and this year, it was much lower. And part of that was related to that we saw slower decision-making in public spending.

So, you know, for example, that we are, if we take design plan as an example, heavily involved in prisons in the UK, and we knew that there were things coming, but they didn't come during the summer. So, we saw delays. I think we have seen that becoming better as we go further out in the autumn.

Whereas, if you look in Sweden, it's the opposite. So, we see the Nordic countries doing a bit better, and that is partly driven by public spending. Both, for example – I gave the example, I think there is a hospital example in the report. But also, when you look into municipalities and outdoor lighting.

And then, we see a little bit slower southern Europe in some parts and, we see segments – of course, we continue to see renovation projects being more active than newbuilds. But I would say this renovation, as I said, has been slower generally. So, that new renovation activity is more driven by the fluorescent ban in the different markets that we've been seeing. So, a mixed picture. I don't know if that answers your question, Mats.

Mats Liss

Analyst, Kepler Cheuvreux SA (Sweden)

Q

Yeah, okay, good. And then, just about the renovation there, I guess you have this different option for the customer to upgrade to LED lighting. And do you see sort of the trend that maybe customers are a bit more reluctant, of course, and delay the project, but do they also sort of trade down and choose a more affordable option for the short term, but maybe not for the longer term?

Michael Wood

Chief Financial Officer, Fagerhult Group AB

A

I think, yes, in answer to both of those questions, we do see – it has surprised us Mats, the consumption of the fluorescent lamps, and now, at some wholesale distributions and some warehouses down to zero, for certain lamp types, not every lamp type. But for certain specifications of fluorescent lamp. And that came quicker than I anticipated.

And that then for us is a positive step in the right direction for renovation. But whether it's a costing or whether it's a speed thing, you know, if you are operating a building with an open-plan office with 80 luminaires in, and 10 of them have gone – don't work because the fluorescent lamps have failed, given end of life, then to keep the work force lit, so to speak, you're going to want to replace that fairly quickly. And the very quick, dirty and nasty replacement is with LED lamps. So, there's a speed comment to the LED lamps.

Whilst Bodil pointed out, yeah, they're not as energy-efficient and they don't last as long, so, it's a little bit – some will go the LED lamp speed of replacement because the office is in semi-darkness, and some which is where we come in, some will go with the proper more professional LED retrofit, LED upgrades, or replacement luminaires, and we are seeing both.

But the LED lamp segment has got to think about a little bit more longer term. That it's not a sustainable solution. It's an immediate solution is what we see.

Bodil Sonesson

President & Chief Executive Officer, Fagerhult Group AB

A

But it should have – I mean, in general, the effect should be positive on us, and we see that. We see that in the markets where it starts to run out.

Michael Wood

Chief Financial Officer, Fagerhult Group AB

A

We see good activity, Mats, with the Fagerhult brand in the Nordic Scandinavian region. And when it comes to healthcare, it's obviously quite an important building to relight, hospitals. So, we see good renovation, resupply of luminaires, LED Luminaires in the healthcare segment in Northern Europe.

Mats Liss

Analyst, Kepler Cheuvreux SA (Sweden)

Q

Great. Thanks. And then, I mean, about the long-term target at 2030, were you – well, your target is to only supply smart lighting solutions. And do you have the full sort of in-house offering there, or, I mean, coming back to the M&A and maybe you have sort of – you have a good, good balance sheet now and could move forward, but if you like, do you need to add more assets, or are you sort of already in place to deliver on the 2030 targets?

Michael Wood

Chief Financial Officer, Fagerhult Group AB

A

I think it will be both. I think – and plus another one that I'll come to in a minute. I think we are busy expanding the application area appropriateness for Organic Response and Citygrid. Remember Citygrid is outdoor. Organic Response is indoor. And there's some luminaire shapes and sizes that it's not suitable for at the moment. And we're busy working there to expand the capability of Organic Response going into a wider portfolio of luminaires, which is positive for us.

There will, of course, always be an opportunity to buy more assets to expand what we do there because there will be some application areas where Organic Response technology might be inappropriate, and we might need a new technology, a different technology for that. So, we are, through Magnus, who's on the call, as you know, we are keeping our eyes open, not just for luminaire-branded assets, but also for smart lighting assets.

And then, the third area that I'd mentioned is partnering. So, we're not discounting a partnering type of approach for smart lighting technologies going forward, in particular, application areas. So, expanding what we do with Organic and Citygrid, adding in new assets where appropriate, and where we have got a gap, but also maybe solving that through a partner approach with somebody that's quite specific.

Mats Liss

Analyst, Kepler Cheuvreux SA (Sweden)

Q

And just coming back to the horticulture, I mean, you exited that business, but, the offering you have today is – you have no sort of – not overlaps, but you don't have any similar measures to be implemented like that, I mean, to exit the business...

Michael Wood

Chief Financial Officer, Fagerhult Group AB

A

No.

Bodil Sonesson

President & Chief Executive Officer, Fagerhult Group AB

A

No.

Mats Liss

Analyst, Kepler Cheuvreux SA (Sweden)

Q

...is that there are no sort of...

Michael Wood

Chief Financial Officer, Fagerhult Group AB

A

No. No, it was a bit of a diversion for our business in Holland over the last three to four years, maybe. So, we've taken the pain, we've exited horticulture, and we don't have any others like that in the group.

Mats Liss

Analyst, Kepler Cheuvreux SA (Sweden)

Q

Okay, great. Thanks a lot.

Michael Wood

Chief Financial Officer, Fagerhult Group AB

A

Thank you. Thanks, Mats.

Operator: There are no more questions at this time. So, I hand the conference back to the speakers for any closing comments.

Magnus Haegermark

Head-Mergers and Acquisitions, Fagerhult Group AB

A

Thank you very much. We have a couple of minutes left in the call, so we can have some written questions as well. Yeah. So, there are significant new EU directives being launched in the coming years and they're related to sustainability. We got a question around this. And the question is, which efforts are you taking to meet these?

Bodil Sonesson

President & Chief Executive Officer, Fagerhult Group AB

A

And I think we spoke about this, I think it was in the Q2, when we went through the European's Performance of Buildings Directive. And I think that we are – we started with this long before it became a directive. So, I think this goes very well into what I said before, that we've been focusing in both the sustainability and the smart lighting. And I would say that, for us, those are the two big important points, which is part of the directive, which, for example, says that in 2030, 16% of the world's energy buildings have to be renovated. And in 2033, it's – I think it's 26%.

So, it's ambitious targets for this. And I've seen the first version of the Swedish legislation for this, which goes very much in line with the European directive. So, I think, this is – for us, this is extremely positive.

Magnus Haegermark

Head-Mergers and Acquisitions, Fagerhult Group AB

A

And a follow-up question on the same topic. Do you see it as an advantage to be a larger company to manage all the administration around this?

Bodil Sonesson

President & Chief Executive Officer, Fagerhult Group AB

A

I think there is a double – actually, it's a good question also, and I think there is a double answer to that. I think with all the legislation that's coming, I think it has advantages to be a group. I think that was the reason that we decided to have Organic Response and Citygrid on a group level, because then we can share the R&D cost between all the different companies. But it's also better from a customer perspective because they get access to a much wider range of solutions with the same interface.

So I think what we've done in terms of product development is also using our decentralized structure. So, we have an ambitious goal where we want to go, but then, we also use the innovation force of the different businesses. And that's how we've been coming up with many solutions within sustainability, but they are different solutions. So, I think we combine the best of both worlds in that with the group or the group and decentralized organization.

Magnus Haegermark*Head-Mergers and Acquisitions, Fagerhult Group AB*

A

Then, we have another written question here about M&A. We touched a little bit on this, but can you just maybe follow up there, Bodil, to start with the M&A activities and how they are progressing?

Bodil Sonesson*President & Chief Executive Officer, Fagerhult Group AB*

A

So, I'm taking your question for you.

Magnus Haegermark*Head-Mergers and Acquisitions, Fagerhult Group AB*

A

Yes.

Bodil Sonesson*President & Chief Executive Officer, Fagerhult Group AB*

A

So, when you look into the M&A side, I think we said it last time, I think it's still held valid and I think the fact that we have you, who's focusing entirely on it, it's very positive because then you can work in a much more proactive part than we have done before. So, we're working on our pipeline on that side of it, very systematically, depending on how it fits into the business areas, but also into different geographical markets that we're scanning completely through.

So, the pipeline is getting more and more interesting. Too early yet to say what's going to happen, but we are working, working hard on it. Okay.

Magnus Haegermark*Head-Mergers and Acquisitions, Fagerhult Group AB*

A

Maybe we have time for a last question here. This one, this maybe to you, Michael, about gross profit. We touched a little bit on this already, but can you just repeat maybe? So, the question is, the gross profit has developed well and can you explain what the reasons for this is?

Michael Wood*Chief Financial Officer, Fagerhult Group AB*

A

Sure. Gross profit has been a key, key focus. We entered the supply chain challenge period maybe 2.5, 3 years ago now. And that was always going to be problematic to manage ourselves through that, but we did. We felt in a good way, and we came out of it in an even stronger way. And I suppose that that challenging period has taught us new things and new processes and new – new approaches to pricing management, but also portfolio management.

Both also those are having a positive impact on the gross profit, the industrial margin development. So, pricing and portfolio management. And then, the third area, I think in – from one of Mats Liss' questions was about component pricing. So, all three, portfolio, pricing, smart pricing tactics – smart as in clever, not as in smart

lighting, but smart – clever lighting – sorry, clever pricing tactics and managing to negotiate lower prices for our cost of materials input, all having an impact on that industrial margin.

Magnus Haegermark

Head-Mergers and Acquisitions, Fagerhult Group AB

A

Okay. Thank you. I think we have time just for a follow-up here. We just got this in about the same topic here. Gross margin is very strong. Do you see and experience any price pressure in the market at the moment?

Bodil Sonesson

President & Chief Executive Officer, Fagerhult Group AB

A

I think that of course, there's price pressure in the markets where you have a [indiscernible] (01:02:24) construction market. But I think we're quite used to work with it and we see this continuing. I think, for us, it's going back to being good at selling our offering also from a smart perspective, because if you heard what I said before, is this is – you can start with the control side of it and then it gives you the bridge into smart lighting.

And of course, our average sales value is higher on that part, but it's also a shorter total cost of ownership for the customer because you need to look at the full solution because you don't have to do the cabling, but also you get additional energy efficiencies when you're doing that. So, I think, for us, that's the way to go and where we need to focus, which we're already doing. But it's – I think, that's the – for us, if we succeed in that, also the gross profit side of it will benefit from it.

Magnus Haegermark

Head-Mergers and Acquisitions, Fagerhult Group AB

Good time is running out for us. And with this, we are done with questions for today. But before we end, Bodil, just a – ending comments from your side?

Bodil Sonesson

President & Chief Executive Officer, Fagerhult Group AB

Yes. I'll give a quick ending comment. So, we were impacted by the slower market conditions in Q3 and I think that's – you've seen us being very quick in taking important cost-reduction measures, and we prefer to do it in that way, so we can see the benefits coming forward. We will continue this focus, and we – on cost benefits to enhance our margin and monitor the market outlook very closely.

And at the same, in line with our strategy, we continue to make progress in all our strategic initiatives, being it sustainability, smart lighting and people and talent, as well as making progress in our M&A agenda. So, I would end by saying, although a somewhat tougher market situation, we continue to see many, many opportunities.

Magnus Haegermark

Head-Mergers and Acquisitions, Fagerhult Group AB

Thank you. And thank you, everyone, for joining today's conference call. Next, we will publish our Q4 results on February 19th of 2025, and we will host a webcast on the same day. Thank you, everybody, and have a nice day.

Michael Wood

Chief Financial Officer, Fagerhult Group AB

Thank you.

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